

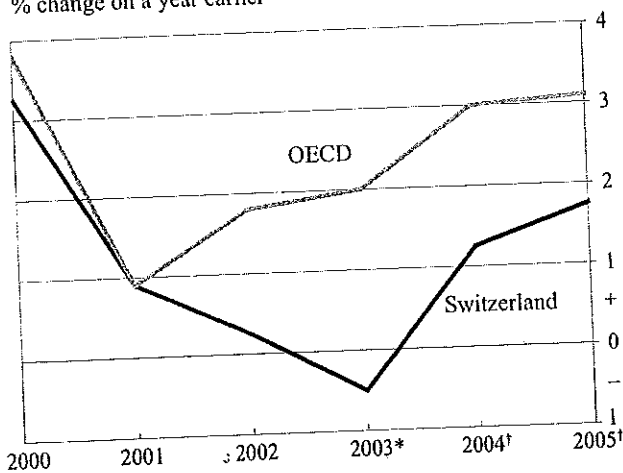
3. Study the extract and data below and answer the questions that follow.

Switzerland

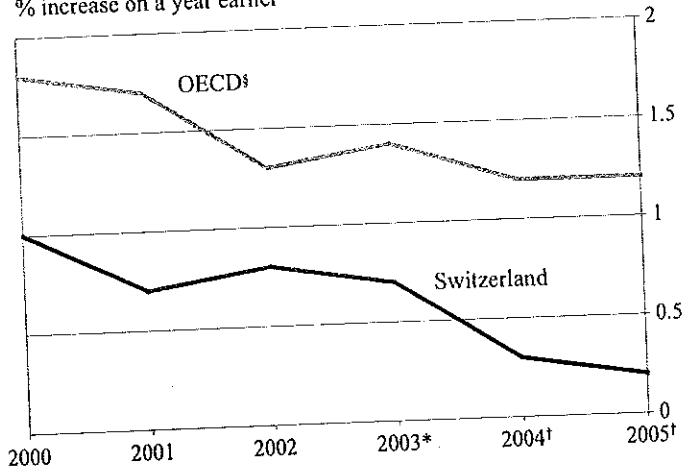
The Swiss economy has suffered in the past two years as businesses have cut **investment** and run down stocks in response to the world downturn. Exports have also been harmed by the appreciation in the Swiss franc. Output stagnated in 2002 and fell by 0.5 % in 2003. Only a modest recovery is likely over the next two years. The OECD* predicts GDP growth of 1.2 % in 2004 and 1.8 % in 2005, which will still leave the economy operating below capacity. As a result, consumer-price **inflation** is forecast to decline to 0.2 % in 2005. The OECD says that, with interest rates virtually at rock bottom, the Swiss National Bank should be ready to take action if deflationary pressures emerge. If it is necessary, the OECD recommends a strategy of intervening in the foreign exchange markets in order to weaken the Swiss franc.

* OECD is the Organization for Economic Cooperation and Development (formed 1961). The members are the EU countries, USA, Canada, Japan, New Zealand, Australia, Mexico and Turkey.

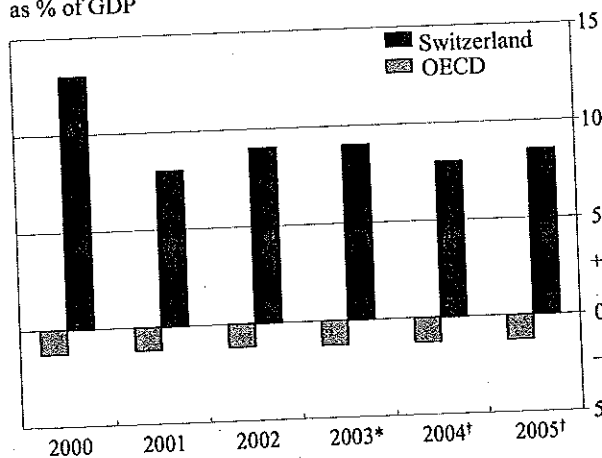
GDP
% change on a year earlier



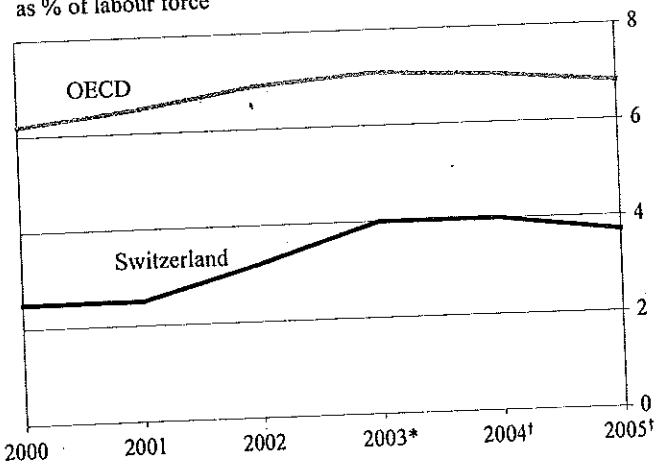
Consumer prices†
% increase on a year earlier



Current-account balance
as % of GDP



Unemployment
as % of labour force



* Estimate † Forecast ‡ Private-consumption deflator § Excluding Hungary, Mexico, Poland and Turkey

[Source: adapted from *The Economist*, February 2004]

(This question continues on the following page)

(Question 3 continued)

- (a) Define the following terms indicated in bold in the text:
- (i) investment [2 marks]
 - (ii) inflation. [2 marks]
- (b) Using an appropriate diagram, explain what is meant by the economy “operating below capacity”. [4 marks]
- (c) Using an appropriate diagram, explain how the Swiss National Bank may be able to bring about the desired change for the Swiss franc. [4 marks]
- (d) Using information from the text, the diagrams, and your knowledge of economics, evaluate the performance of the Swiss economy. [8 marks]